Industry Sector Analysis

Transport

U.S. Commercial Service

European Bank for Reconstruction and Development

INDUSTRY SECTOR ANALYSIS (ISA)

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AUTHOR: AMI BAJANIA

APPROVING OFFICER: GENE R. HARRIS

OFFICER'S TITLE: SENIOR COMMERCIAL OFFICER

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This document is compiled by CS-EBRD. It does not necessarily reflect official EBRD policies and views, or the commitment of the EBRD to funding specific projects mentioned within this report. This is a modified ISA produced to encourage U.S. firms to pursue EBRD funded opportunities in the transport sector, and does not include all of the statistical information on the industry sector markets for each country as CS-EBRD does not have ready access to this data. Figures are based on EBRD public domain documentation. CS-EBRD does not guarantee the accuracy of the data contained.

TABLE OF CONTENTS

SECTION 1: Executive Summary

This Industry Sector Analysis, produced by the U.S. Commercial Service Liaison to the European Bank for Reconstruction and Development (CS-EBRD), aims to:

1. Give an overview of EBRD activities in this sector,
2. Outline recent developments in the sector,
3. Show the EBRD's priorities for this sector by country, and
4. Advise U.S. companies on how to work with the EBRD.

Transport is big business in the 27 countries in Central Eastern Europe (CIS)/Common wealth of Independent States. Spending on transport typically represents 12-15 percent of gross domestic product, including value added in the transport sector, the cost of operating vehicles and own-account transport. Total expenditure on transport in the Bank's countries of operations is probably at least EUR 75 billion equivalent per year.

The EBRD recognizes the importance of the transport sector in the development of the CEE/NIS. Spending on transport typically represents 12 to 15 percent of gross domestic product (GDP), including value added in the transport sector, the cost of operating vehicles, and own-account transport. The Bank has a portfolio of 46 operations, and commitments of nearly EUR 1.5 billion to the sector. Providing improved transportation to its countries of operation is vital to their continued economic development.

Since most projects are in the public sector, commercial opportunities for U.S. companies exist in the procurement process. Interested U.S. firms are encouraged to bid on these public procurement opportunities. There also are opportunities for U.S. companies with suitable private sector projects seeking finance for private sector transport projects due to the Bank's focus on the development of this sector in certain countries and its private sector orientation. The diversity of the transport portfolio indicates that there are broad ranging interests and expertise among Bank officials, which bodes well for U.S. companies interested in approaching the EBRD. There are indirect opportunities for U.S. firms who are interested in supplying goods and services to private sector projects as well as public sector projects as sub-contractors or as consultants.

The Advocacy Center/HDB U.S., Commercial Service Liaison to the EBRD exists to assist U.S. companies in accessing EBRD funding through public sector project procurement, private sector project sponsorship, and consultancies. The U.S. Liaison office also develops and promotes U.S. Company business interests in the EBRD host countries.

SECTION 2: Introducing the EBRD

This Industry Sector Analysis (ISA), prepared by the Advocacy Center/HDB, U.S. Commercial Service Liaison to the EBRD, is part of a series detailing opportunities for U.S. firms in industry sectors in which the European Bank for Reconstruction and Development (EBRD) has a special focus or interest. As this ISA covers opportunities for U.S. firms funded by a multilateral development bank in many countries, the format for this report will differ somewhat from that of a standard ISA.

This document contains information about opportunities for U.S. companies as part of the EBRD's activities in the Transport Sector, and steps that U.S. firms may take to access EBRD funding. This document includes:

- The importance of the EBRD as a source of finance, and opportunities for U.S. firms;
- An overview of the Bank's strategy in this sector;
- Breakdowns of EBRD transport activities in its countries of operation;
- Case studies of EBRD projects in this sector;
- Projected opportunities for U.S. companies in this sector; and
- Next steps - how to work with the EBRD.

T*he Importance of the EBRD as a Source of Financing in the Region*

The EBRD is one of the most important sources of investment in the CEE/NIS region, and in many countries the most important source. Thus, there are important opportunities for U.S. firms willing to make the effort to bid on public sector projects, propose private sector projects for EBRD finance, or provide consultant or technical assistance services.

The Bank was established in 1991 to assist the former communist countries of Central and Eastern Europe and the CIS (Former Soviet Union) in their transition to market economies. Applying sound banking principles, the EBRD works with corporate partners to finance projects in both the private and public sector. The EBRD is a long-term reliable business partner with expertise across a broad range of sectors that provides innovative and flexible solutions to public and private companies' financial needs. The EBRD has 61 member countries, plus the European Investment Bank (EIB) and the European Union (EU). The U.S.A. is the largest single shareholder in the Bank contributing 10 percent of its Euro 20 billion in subscribed capital. Unlike other multilateral development banks, the EBRD focuses on the development of the private sector and the infrastructure to support it. However, some 15 percent of the EBRD funding goes to public sector projects.

Working with the EBRD:

Funding from the EBRD, a major multi-lateral development bank, is available to all companies that have a viable project in the EBRD's countries of operation.

Hundreds of U.S. companies from a broad range of industries have been successful in working with the Bank since 1991. There are three main ways to work with the EBRD: As borrowers or investors in private sector projects with the EBRD participation; as bidders, tenderers, or contractors on EBRD projects carrying our works, or supplying goods and services on public and private sector projects; as consultants carrying out projects, as well as general operational and technical assistance on behalf of the EBRD.

The EBRD is not an import/export bank, and as such, does not fund directly the exports of goods and services. However, its funding or involvement in projects may result in the financing of goods and services related to those projects. In addition, some of the financial institutions and banks and some of the funds that the EBRD has helped to establish, however, are sources of finance to local companies for the import of goods and services.

This document is designed to make U.S. companies aware of EBRD activities in transport and to access opportunities in this sector. More detailed information on working with the EBRD may be found at the end of this document. The transport sector in CEE/CIS is a very important sector for the overall economic development of the region.

SECTION 3: Introduction to the EBRD Involvement in the Transport Sector

The Transport sector is an important sector for the Bank because it plays a crucial role in the development of the economies and markets of the EBRD member countries. The Bank believes that safe passenger transport is important for commuting, business, and leisure industries. The Bank believes that efficient and reliable freight transport services are essential factors in enabling enterprises to compete effectively in domestic and international markets.

The average EBRD financing has been EUR 33 million, generating an average of EUR 240 million of transport business for the bank each year. The Bank has undertaken 108 projects in the Transport sector valued at 11.3 billion and total of 3.5 billion funding commitment for the Bank. In the last 5 years, the average annual volume of transport business was EUR 411 million.

The Bank has invested more than Euro 1.2 billion in transport infrastructure, representing about 16 percent of the Bank's overall portfolio. Transport infrastructure includes airports and air navigation, ports, railway network and train operating assets, but excludes airlines, shipping, and manufacturing. The high percentage of financing committed to the roads sector during the early years of operations reflected the large demand for investment in the region. More recently transport sector, however, the portfolio has focused on road and railway projects, and more than half of all commitments in 2004 were to the road sector.

The Bank will continue to cooperate with the EU on the development of the Trans-European Network corridors and implementation of regional initiatives, such as the REBIS (Regional Balkans Infrastructure Study) initiative in the Western Balkans and the TRACECA (Transport Corridor, Europe - Caucasus-Asia) initiative in Central Asia and the Caucasus. Continuing co-operation with other IFIs, such as the EIB, International Monetary Fund, World Bank Group and the regional development banks is also a feature of the EBRD's strategic approach. Environmental issues arising from developments in transport have been highlighted and the Bank will continue to cooperate also with other IFIs in seeking to address these issues in the most appropriate manner.

In addition to infrastructure investment, the Bank also provides technical assistance to prepare investments and optimize project effectiveness. Examples include studies related to the rescue of the Port of Aktau (Kazakhstan) from inundation by the Caspian Sea; railway restructuring policy and investment studies in Russia and elsewhere; a feasibility and forecasting study of intermodal transport in Hungary; and assistance in drafting concession legislation in Poland

and Romania. Overall, the Bank has undertaken more than 80 technical cooperation projects in the transport sector.

SECTION 4: The EBRD's activities in the Transport Sector

The Bank has undertaken 108 transport projects in the period from 1992 to end December 2004. The average EBRD financing has been EUR 33 million, generating an annual average of EUR 240 million of transport business for the Bank each year. The average number of projects undertaken each year has typically been 9 with numbers of projects in recent years being 2000: 7 projects; 2001: 10 projects; 2002: 9 projects; 2003: 10 projects; and to end December 2004: 10 projects. In the last five years, the average annual volume of transport business was EUR 411 million.

At end December 2004, Road projects have accounted for 52% of the business, and rail projects for another 29%; aviation sector projects accounted for 8%, ports 3%; shipping and water transport projects 7%; and other support activities for Transport 1%.

Transport business has been heavily oriented towards the state sector because of the customary involvement of the state in the provision of transport infrastructure, both in countries of operation and outside them and the issues relating to land acquisition, environmental issues and planning, which militate against a laissez-faire transport system. Out of a total of 108 projects at end December 2004, 77 have been sovereign loans, with a further 4 sub-sovereign projects in the state sector. However, the number of private sector projects is increasing: while only 15 private sector projects were signed in the first eight years of operation, 19 such projects have been signed in the period 2000-end December 2004. Private sector projects constitute 43% of an active pipeline. About 39% percent of the lending volume has been in the Central Europe country grouping; 32% in the SEEC country grouping; 19% in Russia; and 10% in Central Asia.

SECTION 5: EBRD Strategy for Transport Sector Investment

5.1 EBRD Comparative Advantage in the Transport Sector

The Bank seeks to finance economically viable transport infrastructure and services, and transport industry projects, where and when it has a comparative advantage deriving from:

- Its in-depth regional knowledge and expertise, and local presence through its network of regional offices;
- Its professional expertise in particular technical areas;
- Its capability in enterprise restructuring and privatization;
- Its skill in financial engineering; and
- Its ability to operate in the private sector, public sector and, increasingly, in the difficult middle ground of public-private partnerships.

The Bank exerts influence on the creation and supervision of competitive markets through technical cooperation and sovereign lending that incorporates transition-linked conditionally. It is essential that the Bank be present from the outset, so that it can act as a reliable partner through the various transition stages. Due to its unique mandate, the Bank can bear certain risks and thus operate at the frontier of commercial possibilities, using its wide range of instruments.

5.2 EBRD Opportunities and Objectives in the Transport Sector

Although opportunities for U.S. companies through the EBRD are numerous, rarely are they in the form of simple exports. Funding from the EBRD, a major multilateral development bank, is available to U.S. companies as well as almost all other international firms.

Dozens of U.S. companies from a broad spectrum of industries have been very successful in working with the bank since 1991. There are three main ways of working with the EBRD:

1. As borrowers/investors in private sector projects with EBRD participation;
2. As bidders/tenderers/contractors on EBRD projects carrying out works, or supplying goods and services on public sector projects;

3. As consultants carrying out project specific as well as more general technical assistance projects and studies on behalf of the EBRD.

As stated earlier, most of the EBRD's projects in this sector are public projects in which the EBRD grants a loan to a government to finance the project. In addition to sovereign loans, the Bank utilizes equity investments and finance facilities.

Role of the Public Sector

The Bank's 27 countries of operation are emerging from an era in which the state planned the size, nature and distribution of transport, regulated the transport system, designed and constructed the infrastructure, and provided most services. In contrast, transition to a market economy requires governments to focus on the creation and supervision of competitive markets with the minimum regulation necessary to protect the public interest and allow companies to work efficiently.

Governments will continue to play a crucial role in the strategic development of transport systems through activities such as determining the location of major airports, seaports, strategic motorway and rail links, and negotiating international aviation and other agreements. Governments may choose to retain ownership of strategic transport assets where privatization might create concentrations of private market power that cannot be regulated satisfactorily, or that are publicly unacceptable. However, this justification usually applies only to infrastructure assets, as public ownership of transport operating assets is rarely necessary.

The EBRD encourages central governments and municipal authorities to place transport services on sound financial foundations. Public authorities are free to pursue the social policies of their choice, such as ensuring the mobility of pensioners or the maintenance of basic services in rural areas. In such cases, the client authority should purchase social services from commercial suppliers on a contractual basis, making maximum use of competitive tendering to achieve value for money. Transport operators should not be required to bear the costs of social policies decided by others.

Private Ownership and Control

The first transition step in the transport sector is to corporatize a publicly owned operational entity such as an airport. In the interests of transparency and financial discipline, the EBRD generally requires the unbundling of activities and the creation of a corporate entity for each major function. One example would be the separation of airline and airport activities. While commercialization can reduce the risk of over-investment in technical standards or excessive capacity, experience suggests that corporatization alone does not create the same strength of efficiency incentives as private ownership, and limits rather than prevents political interference in operational decisions. Nevertheless, the Bank supports corporatization as a first step along the transition path.

The second transitional step is to privatize equity within the chosen corporate entity.
Privatization concentrates on shareholder value and minimizes the scope for compromising efficiency and market focus through the pursuit of political goals, which characterizes state-owned companies.

Transition is being achieved in the transport sector through a mixture of corporatization and increased private sector involvement. In the railway industry, for example, the Bank supports corporatization of the core functions of network management and freight and passenger transport, together with greater involvement of the private sector in ancillary industries such as heavy maintenance, terminal operations, and train catering. The Bank plans to assist in the privatization of some of the core operating activities. With a few exceptions, a prerequisite for Bank participation is that the borrower be a corporate entity. All assets required for the day-to-day business of the entity should be under management control, and managers should have freedom to make decisions regarding the long-term sustainability of the business.

Airports play an important regional role in large countries. The Bank favors the transfer of ownership and control from central government to a company at the regional level, owned by private interests and/or regional government. Where vertically integrated entities exist, the complete legal and managerial separation of main activities is generally a condition precedent to Bank financing.

Ports constitute important gateways for manufacturing entities to the international marketplace. The efficiency of port operations means substantial reductions in transport costs and delivery times. The Bank favors the involvement of private port terminal operators in superstructure investments as a means of increasing cost-effectiveness and accountability in third party claims for damages or delays.

The Bank fosters the transition of public railway enterprises by investing in asset modernization, linked to conditionality with respect to the development and implementation of restructuring strategies. The Bank does not advocate a single restructuring model, but the model must involve the commercial management of railway enterprises regardless of whether these are train-operating entities, network authorities or railway supply industries, or privately or publicly owned. The Bank supports the creation and functioning of competitive railway supply industries. It also advocates competitive transport markets without special protection of railway markets, since users' needs and preferences are expressed through free and fair markets. Consequently, Bank lending to publicly owned railways is subject to two conditions:

- The commitment of senior railway managers to a commercialization process and to responding effectively to competitive transport markets; and

- The commitment of government owners to support that transition with an appropriate legislative framework and transparent financial arrangements to support non-commercial activities imposed by government.

In the roads sector, the Bank encourages the separation of strategic planning and regulatory functions from construction, operation and maintenance. The latter should be divested by the public sector and carried out by private, corporate entities.

Environment

In line with the Bank's Environmental Procedures, all transport operations undergo environmental appraisal. The purpose is twofold. First, to help the Bank decide if an activity should be financed. In this regard, an operation can be rejected on environmental grounds when there are major environmental problems or where an operation fails to handle environmental issues in a satisfactory way. Secondly, environmental appraisal is carried out to identify ways in which operations can be designed, financed and implemented to provide environmental benefits and improve environmental quality.

As with economic, financial and technical matters, environmental appraisal is essentially the responsibility of the project sponsor. The Bank's role is to determine the type of appraisal needed, provide guidance on how it should be conducted, review the results, and ensure that findings are properly reflected in operation financing and implementation.

The types of environmental appraisal most often undertaken in the transport sector are an Environmental Impact Assessment (EIA) or an Environmental Analysis. An EIA is carried out to identify, predict and assess the likely future environmental impacts associated with a particular operation where the impacts are potentially significant and cannot be readily identified, assessed or mitigated.

Certain types of transport operations will be subject to an EIA, regardless of their location. These include the construction of motorways, major highways, railway lines, airports with a runway length of 2,100 meters or more, sea ports, and inland waterways and ports that permit the passage of vessels of over 1,350 tons. Operations that affect environmentally protected or sensitive areas, such as national parks or nature reserves, may also be subject to an EIA.

An Environmental Analysis is carried out on transport operations where any future impacts are potentially significant but where, because of their nature, size and location, they can easily be identified, assessed and mitigated.

An Environmental Action Plan (EAP) is prepared as the result of the environmental investigations and is developed by the project sponsor. The purpose is to obtain an agreement concerning key environmental, health and safety performance criteria, corrective actions and improvement programs, and to define monitoring and reporting requirements.

EBRD operations are structured to meet national and existing EU environmental standards or, where EU standards do not exist, national and World Bank standards.

Investment Needs

Anticipated demands for transport infrastructure financing in the Bank's countries of operation are large. The EC estimates that external financing in the order of Euro 20 to 30 billion will be required over the period from 1996-2005. Since 1990, the International Financial Institutions (IFIs) have committed Euro 2.6 billion to the sector, averaging Euro 400 to 500 million per year. The study concluded that the flow of IFI funds needs to exceed Euro 1 billion per year from 2000 and to increase thereafter, in addition to a flow of at least Euro 1 billion per year from the EU and Euro 500 million from the financial markets.

5.3 Guiding Principles for Transport Projects

As with all Bank operations, transport projects are scrutinized with respect to a trilogy of principal criteria: transition impact, additionality, and sound banking principles. Each proposed project must also satisfy criteria relating to procurement, economic viability legal and other aspects, and all Bank operations undergo environmental appraisal to help the Bank decide id as activity should be financed and, if so, the way in which environmental issues should be incorporated in financing, planning and implementation. Further, the Bank pays careful attention to portfolio balance, credit quality, cost/productivity issues and profitability, and ensures that each proposed transport project is consistent with the relevant Country Strategy.

The Bank responds to market demands and does not allocate lending slots by country or by sector. However, application of the Bank's country exposure and portfolio ratio limits are necessitating some form of programming for public sector operations. Since transport infrastructure projects tend to have long lead times(typically 2-3 years), the Bank has to commit resources to project preparation well in advance of knowing the political and economic circumstances in the host country, and the Bank's actual exposure and country portfolio ratio at the time decision has to be taken.

A priority will be to mobilize private finance for transport infrastructure, through concession and Public-Private Partnerships (PPPs). The Bank expects to turn its attention increasingly to co-financing operating assets and transport services with the private sector, leaving traditional infrastructure financing to institutions such as the European Investment Bank (EIB) and the World Bank, which have a mandate for sovereign lending in those areas. EBRD will, however, pursue sovereign operations where: (a) its financing is truly additional, (b) substantial transition impacts can be achieved, and (c) strong environmental and/or energy efficiency arguments can be made to justify using limited sovereign exposure (for example, in the case of urban transport). The Bank will engage in lending for Trans-European Networks (TENs) infrastructure where additional private capital can be mobilized or where significant impacts are anticipated.

The EBRD will encourage other financiers where sound projects do not fall within the Bank's mandate. As the Bank is project-driven, it engages in sector work only to the extent necessary to identify viable investments. Although Bank projects frequently include institutional development, human resource development is generally left to programs such as PHARE and TACIS.

5.4 Lines of Business

The EBRD will pursue six lines of business in which it has a comparative advantage:

- Aviation
- Ports
- Railways
- Road Transport
- Shipping
- Urban Transport

Aviation

Currently, the Bank is financing ten operations and is on of the few International Financial Institutions (IFIs) active in this sub-sector. There is considerable scope for private and PPP operations, especially in large countries such as Russia. The Bank will consider investment in civil aviation infrastructure, which constitutes the essential infrastructure for a competitive aviation environment and usually generates hard currency revenues.

The Airport investment may include runway, taxiway and apron improvements, lightening and navigation systems, passenger and cargo terminal buildings, ground handling equipment, office building for the airport enterprise or catering centers, ancillary equipment, and environmental infrastructure.

The Bank will continue its efforts to modernize air reservation systems that constitute a marketplace for passenger and cargo air transport services, and are a vital tool to improve airline efficiency and market orientation. The Bank can consider financing the hardware, software, equipment implementation and user training.

In air navigation sector, the Bank will continue to assist national authorities to improve safety and increase capacity where necessary. Implementation of such projects will normally include clear and transparent cost recovery from users (through en-route charges), paving the way for private projects or public-private partnerships.

The Bank is unlikely to finance Western aircraft, due to lack of additionality, but may consider financing aircraft and equipment manufactured in the region, and participation in airline restructuring or privatization, or investment in fixed equipment. However, the Bank has and plans to finance used aircraft for smaller, marginal airlines to ensure they use safe but less expensive aircraft. The bank will support the projects of subsidized flag carriers only if such projects are associated with restructuring and the removal of direct and indirect subsidies. In countries where free market principles already prevail, the bank will encourage the development of airlines with financial performances consistent with sound banking principles.

Ports

Port projects can have important transition impacts within the sector by developing modern facilities and improving management, and externally by facilitating trade and achieving environmental gains. The Bank believes that there exists unexploited market potential exists for private sector operations in this sub sector, especially where hard currency revenues are available.

Many ports are capable of substantially larger throughput, without major investment. Both productivity and throughput could be increased by better coordination with inland transport (especially the availability of rail wagons for direct loading/unloading), modest investment in storage facilities and improved management.

In considering potential port investments, the Bank distinguishes between basic infrastructure (such as breakwaters and berths) and superstructure (such as buildings and cranes). The Bank can finance basic infrastructure on a sovereign basis, where it believes that the transition impact will be high, Bank financing is genuinely additional, and will facilitate private sector investment, probably in specialized terminals.

The Bank will support the restructuring and commercialization of ports, encouraging private sector operation of the superstructure. The Bank may continue to undertake sovereign transactions for rehabilitation, upgrading and development of port infrastructure by landlord ports, where there is an emphasis on restructuring and commercialization. It will also develop non-sovereign loans to commercialized state-owned entities and loans to the private sector where it is involved in port operations.

Privatization may start with the use of private services leading on to private terminals and, in some cases, privatization of the port authority itself. Potential projects must be financially viable and be underpinned by robust traffic forecasts. High quality management, capable of change, is also essential. In some cases, this may be achieved through the short-term involvement or equity participation of a Western operator.

Railways

Considerable scope exists for both sovereign and private sector operations related to infrastructure and services. The Bank supports a wide range of investment components, provided they are associated with necessary commercialization and restructuring, such as:

Network operations

- Upgrading line speed and capacity, if justified by traffic volumes and economics
- Infrastructure maintenance and equipment renewal
- Railway telecommunications/data communications networks
- Rail transport operations
- Rolling-stock rehabilitation
- New rolling stock
- Improvement to terminals and terminal equipment, especially for freight and intermodal traffic
- Depot modernization and maintenance equipment
- Traffic/rolling stock management systems to improve efficiency and service

When assessing individual investment components, the Bank encourages railway owners to divest non-core activities rather than reinvest, and to procure railway support services from external markets where feasible. Private participation in the railway industries contributes greatly to transition through various forms:

- Privatization or joint venturing of manufacturing or heavy repair enterprises owned by or allied to public railway enterprises

- Outsourcing of network operations support activities, for example infrastructure maintenance and renewal, telecommunications systems, property services, facilities management

- Outsourcing of the transport operations support activities, for example rolling stock maintenance, train and station catering, terminal management, cleaning services, security, travel agency activities and advertising

- Procurement of equipment from leasing and rental companies, for example rolling stock, terminal equipment

- Concessions for specific rail operations, such as intermodal services

Legislative and financial frameworks can be introduced which allow access to rail networks by private operators, either through track access rights or concession/franchise arrangements. In the freight sector, the Bank recognizes the need for the emergence of private freight companies operating long-distance international freight and intermodal services over the European network. Such operators would offer a “seamless” service to overcome the historic fragmentation of responsibility between individual national rail systems.

The Bank will continue to pursue sovereign operations in support of railway restructuring and modernization in all its countries of operations where continuing transition impacts and additionality exist. In view of its emphasis on transition, the Bank will not invest in rail infrastructure upgrading without adequate restructuring of rail transport operations to support long-term financial sustainability, and will seek the cooperation of other IFIs and lenders in this effort. The Bank will actively seek and support viable non-sovereign, private sector operations where their feasibility is underpinned by sound business plans and an adequate policy framework.

The Bank is willing to support projects in the intermodal rail freight sector, including infrastructure, terminals, specialized equipment, management information systems and logistics support services. Intermodal transport is a generic term loosely referring to traffic that is transferred between sea and rail, or road and rail, or sea, rail and road for different parts of its journey. It includes containers, swap-bodies, loaded trucks carried on trains and several other specialized forms of transport. Intermodal transport, which combines the line-haul advantages of rail with the distributional flexibility of road, has been one of the fastest growing components of North America and west European railway freight in recent years. In western Europe, intermodal represents about 8 percent of the rail freight task.

Railways are at varying stages of transition in the Bank’s countries of operation, reflecting the political sensitivity involved in the restructuring process. The Bank will continue to support railway restructuring and commercialization, including labor restructuring programs. In this way the Bank can help to ensure that Railways receive the level of funding commensurate with the benefits associated with this mode of transport. There may be opportunities for private sector financing, as freight forwarders seek to fill the gaps in the market for modern freight wagons. These transactions may be asset-based. The drive to optimize the use of railway assets will provide opportunities for the Bank to finance private concessionaires operating public assets, such as railway stations. There may also be interesting equity opportunities given the expanding market.

Road Transport

Modern economics depend upon an efficient road transport industry. Studies suggest that the provision of road transport infrastructure is associated with an increase in the productivity of private enterprises.

Roads are only the “track” that sustains a large and complex industry. Although generally planned, procured and owned by the public sector, roads are usually built by private companies. The public provision of roads is the norm in Western Europe and elsewhere, due to the complexities of land acquisition, the importance of network integrity, and the difficulty of charging at the point of use. Where direct charging is feasible, for example, tolled motorways, tunnels and river crossings-private sector concession may be possible.

There are many opportunities for private and entrepreneurial initiative within the road transport industry: trucking provides opportunities and produces flexible services required by Small and Medium-sized Enterprises (SMEs); freight forwarders facilitate efficient line-haul operations; inter-urban buses can often run profitability; taxi services are required in urban areas; vehicle maintenance and repair shops, and motorists services are increasingly required by the expanding vehicle fleet. Free markets work well in road transport and this is one of the first areas to attract private capital. Regulating should be kept to a minimum, covering principally vehicle and driver safety, emissions, axle loads, dangerous goods and respect for commercial laws.

Free markets work well in road transport and this is one of the first areas to attract private capital. The Bank will give priority to financing sound private sector or PPP revenue-generating infrastructure projects, and to private sector transport services. The Bank expects to be active with respect to toll motorways, where it can play a catalytic role. All projects will be required to meet economic as well as financial criteria.

The Bank will continue to support rehabilitation; upgrading and construction of new roads, where investment needs have increased in line with economic growth and a move towards greater regional integration. Sovereign transactions are expected to dominate the Bank’s activity in this sector, as the economic benefits of roads are difficult to monetise. However, the Bank will continue to support institutional development, reform of road sector financing and increased commercialization of the sector. The Bank will also support the involvement of the private sector through PPPs, as governments seek to benefit from private sector efficiencies and increase the number of projects, which can be implemented simultaneously. PPPs will not be limited to construction and operation of road infrastructure, but may also cover the provision of services to road users (catering, rest areas etc.). The Bank will support moves to more transparent road changing, addressing the costs associated with this means of transport. In particular the introduction of vignette schemes and electronic road pricing are seen as useful tools to ensure that road vehicles bear an appropriate cost burden.

Through the flow of funds and the application of rigorous tendering procedures, the Bank is instrumental in developing and internationalizing construction markets. The Bank supported European Road Rehabilitation Project in Romania, for example, pumped ECU 300 million into the local construction market and has fostered the upgrading of local contractors and consultants through joint ventures and subcontracts with international firms. The bank seeks private sector investment opportunities related to the supply of construction materials, intelligent highway and vehicle systems, and other activities.

Shipping

The Bank has successfully financed seven shipping and ship building operations, with the total Bank commitments of EUR 156 million towards total investment of EUR 709 million.

It is likely that the seaborne trade of the Bank's countries of operations will grow faster than the world trade as a whole as consequences of trade diversion, thus increasingly regional demand for shipping and ship-building, Trade creation and diversion are already playing, and will continue to play a crucial role in transition. In many countries, exporters see the major obstacles in expanding their activities lying in both physical and financial infrastructure. Investments in the industry play a part in lowering the obstacles, thereby opening the economy and advancing transition.

In the Bank's countries of operations, fleets are older that the world average, an inheritance of the priorities of the old regime. This will generate demand for proportionately speedier fleet replacement. The size of the total world fleet has stagnated since mid 1980s, with less that 1 per cent growth since 1987. However, the number of container vessels, non-oil tankers and single deck ships has grown significantly, There has also been a trend towards bigger ships.

The market consensus is that aggregate replacement demand will grow substantially, particularly for tankers and dry bulk carriers. The trend towards bigger ships is expected to continue. In addition, increased trade is expected to result in sufficient demand to require a significant increase in the total fleet size, and replacement demand is expected to account for the majority of total new building. Overall, up to the end of the century, replacement demand is expected to account for the vast majority of total new building: consensus forecasts are for total new building demand of around 18,000 ships, of which about 15,000 will be to replace existing ships.

A major change in the country market share of world ship building output took place in the 1980s. At the beginning of the decade, Asia produced about half of world output; that region now produces more than 75 percent, with the biggest single increase by far having taken place in South Korea. The Bank's countries of operations experiences a sharp decline in ship building output and the trends appear to have continued into the 1990s.

The Bank will consider financing a variety of vessel types, including tankers, dry bulk, container and Ro-Ro. The scale of the Bank's operations is small in relation to total demand, accounting for well under 1 percent of the world market.

The countries of operations no longer have the type of discriminatory practices that they exercised under centralized economic policies and their practices are approaching, and in many cases mirror, those of other nations with maritime interests. Bank-supported operations must comply with international statutory requirements, including those of the International Maritime Organization, such as those specified in the Maritime Pollution Convention (MARPOL) and the International Convention for the Safety of Life at Sea (SOLAS), and with all appropriate regional conventions.

The Bank will continue to support restructuring, commercialization and privatization of state-owned shipping companies. The Bank may undertake operations with privatized or commercially run companies, which need to replace ageing and obsolescent fleets. These transactions may involve asset-based financing to mitigate credit risks. In shipbuilding, the Bank will continue to seek restructuring opportunities, where shipyards potentially have a competitive edge. As the financial robustness of the yard can be an issue, finance may be restricted to specific contract orders or sovereign guaranteed transactions.

Urban Transport

Having regard to the inevitable increases in motorization and the importance of urban transport for sound and sustainable development, the EBRD intends to develop its portfolio of operations in this sub sector. The Bank will work with private and municipal project sponsors to develop freestanding operations. However, where progress is inhibited by national issues such as (non-funded fare privileges), the Bank will also work with central governments to reform the regulatory and financial framework to facilitate sound development.

To be eligible for Bank financing, urban public transport services should be provided on a commercial basis by corporate transport operators (whether privately or municipally owned). Operators' cost should in future be fully covered by revenues derived from: (a) the fare box, (b) compensation for travel privileges/exemptions awarded by public authorities as a matter of social policy(for example, students and pensioners), (c) payments for predetermined services or activities purchased from operators by public authorities (public service obligations), and (d) other earned revenue. Public authorities are free to pursue the social policies of their choice, but each granting authority to beneficiaries. The regulatory framework should ensure that operators are not being required to carry passengers without corresponding payment. Where necessary, the Bank will work with central government and municipal authorities to address institutional constraints.

The Bank's priority is to develop non-sovereign operations through lending to private companies or to municipalities or municipal entities where creditworthiness is established or satisfactory guarantees provided. When this is not feasible, the Bank will work with central governments to develop and implement a reform program and will consider financing priority investments on a sovereign basis.

Circumstances vary between individual countries and cities, but projects may include some or all of the following: (a) the unbundling of bus and truck operations into separate legal entities, where currently together; (b) where urban public transport assets are currently owned by the state, the assets would be decentralized to the relevant municipalities or privatized, (c) responsibility for all aspects of urban public transport planning and regulation would be vested in municipalities, (d) electric transport operating entities may be corporatized, under municipal or mixed private/municipal ownership, or operations franchised or privatized, (e) bus entities and assets would be privatized, and services tendered and franchised by municipalities, as soon as practicable. The Bank encourages the establishment of multi-year performance contracts between municipalities and transport operators for services on a core network. The Bank considers financing infrastructure provided by a public authority or a private company, and/or operating assets such as rolling stock.

Demand management, which includes traffic management, is likely to become increasingly important in urban areas. This will help to manage scarce road capacity, limit the intrusion of motor vehicles and protect public transport services from road congestion caused mainly by private vehicles. The Bank may consider financing public transport priorities and parking management systems.

Technical cooperation may be available to help municipalities develop their institutional capability to:

- define a core network;
- establish and manage performance contracts;
- franchise services;
- design and implement public infrastructure transport priorities and parking schemes; and

- develop their creditworthiness to support debt servicing.

Assistance may also be available for participating companies with respect to management information systems, which include cost accounting and operating methods. Strategic partnerships between local and western private companies are encouraged.

5.5 EBRD Strategy for Investment by Country

The EBRD divides its countries of operation into different categories based on where they in their transition towards a market economy. These categories are Early Stage Transition Countries, Intermediate Transition Countries, Advanced Transition Countries, and Russia.

5.5.1 Early Stage Transition Countries

In early 2004 the EBRD launched a new initiative to increase its activities in the seven 'Early Transition Countries' (ETCs). These are the poorest EBRD countries of operations: Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan.

The initiative aims to stimulate market activity in these countries by using a streamlined approach to financing more and smaller projects, mobilising more investment, and encouraging ongoing economic reform. The initiative builds on international efforts to address poverty in these members of the Commonwealth of Independent States (the former Soviet Union).

The Bank will accept higher risk in the projects it finances in the ETCs, while still respecting the principles of sound banking. To increase its investments in these countries the EBRD has allocated more staff to work on ETC projects and has created a new team dedicated to the initiative

The ETCs have lagged behind the rest of the region in their transition to market economies and more than one out of every two people live below the poverty line.

Economic development is hindered by a number of factors:

- National debt is extremely high in most of the ETCs;
- Reform and improvement of key institutions – banks, courts and regulatory authorities, state enterprises, infrastructure – is slow, as is the transition to democracy and stability;
- Business skills are lacking;
- Domestic markets are small, distances large, borders are difficult to cross (whether by goods or people);
- Basic services from roads to telecommunications are not in good shape.

This poor investment climate, which discourages foreign investment, will be addressed by the initiative:

- At the micro level of individual project finance and advisory services to local enterprises and financial; and
- At the macro level of policy dialogue and institutional reform in selected sectors.

Focus on private sector

Priorities for each of the ETCs will be set out in the relevant EBRD country strategy and will take into account national poverty reduction strategies.
The EBRD initiative emphasises private sector development, particularly in micro, small and medium sized enterprises (MSEs and SMEs). These enterprises offer the greatest opportunities for creating sustainable employment and prosperity. They also can have a positive impact on a country's transition to democracy: their owners have a stake in improving the ways laws and regulations are made and implemented, and in reducing corruption.
The EBRD has developed and/or adjusted several financing instruments dedicated to the funding of local entrepreneurs and enterprises, to better address ETC needs.

Armenia

Armenia is committed to the principles of multiparty democracy, pluralism and market economics in accordance with the conditions outlined in Article 1 of the Agreement Establishing the Bank, although application of these principles in the previous Strategy period has been uneven. While economic performance has been generally good, and Armenia has made encouraging progress on liberalization and selected structural reforms compared with other economies of the region, questions regarding the conduct of presidential and parliamentary elections in 2003, media freedom and rule of law are a source of concern. Since independence, Armenia had built a strong record of progress on democratic reform, which led to their accession to the Council of Europe in 2001. The newly-elected authorities have an opportunity to return to that political course, which would restore public trust and underpin the policy steps needed to address the country's remaining transition challenges. On the dispute over Nagorno-Karabakh, the authorities demonstrated their commitment to negotiations but a final resolution has proven elusive. Until this matter is resolved, Armenia's partial isolation in the region will continue to impede the country's economic development and stall the creation of important regional initiatives in the Transcaucasus.

The Bank may consider providing financing for the investment needs of the railway system with the main focus likely to be both refurbishment and new rolling stock. The Bank's investment would be linked to further commercialisation of railway activities, institutional strengthening, and the further facilitation of international trade.

Prior to independence, Armenia Railways operated a network of 796 km of main track running from Yerevan to Turkey, Iran, Azerbaijan and Georgia. As a result of the conflict only the line from Yerevan to Tbilisi totalling 350 km is open, providing a link to the TRACECA corridor. The railway serves as a lifeline for the importation of bulk goods such as petroleum products and wheat shipped through the Black Sea. The needs of the railway system are considerable for both track renewal and rolling stock and these will increase as borders are opened and links re-established. The former Armenia Railway Corporation has been separated into three operating companies (infrastructure, rolling stock and operations) and for the first time in 2002 freight was profitable.

Azerbaijan

Azerbaijan is committed to the principles of Article 1 of the Agreement Establishing the Bank. However, the progress achieved in the implementation of the principles of multi-party democracy, pluralism and market economics has been slow and uneven, and many challenges remain.

Although an improvement over previous elections, the presidential elections of October 2003 failed to meet international standards for democratic elections. The OSCE and the Council of Europe urged the authorities to remedy the defects that became apparent during the electoral process. The parliamentary elections scheduled for November 2005 will be a significant opportunity for demonstrating progress in the proper functioning of democratic institutions.

The Government's current economic development strategy focuses upon the complementary objectives of non-oil and gas sector development and regional economic development. Critical to the achievement of these objectives is the creation of an efficient economic infrastructure.

The Bank will continue to focus upon improvements to the transportation network in Azerbaijan, in particular on investment opportunities in the road and rail sectors. The Bank will seek to complete the financing of the Baku–Samur Road project with the Ministry of Transportation. A second railway project will also be considered during the Strategy period.
The Azerbaijan State Railway is in discussions with the EBRD seeking financing for more efficient locomotives and for the capacity to maintain and repair locomotives. Commercialization of such operations will be the focus of the Bank's related conditionality.

The Bank will also focus upon much needed improvements in the power sector, seeking to work with the state energy company, Azerenergi. The largest power

plant in Azerbaijan, AzGres, is in urgent need of capital investment if it is to maintain its current levels of output.
The focus in the power sector will be upon regulatory and tariff policy reforms and on restructuring.
In Baku, the Bank will continue discussions on the development of a solid waste management program and on the development of a new port. Both which will require a strong commitment to commercialization, cost recovery and other project related reforms.

Georgia

Georgia remains committed to and is making significant progress in applying the principles of Article One of the Agreement Establishing the Bank. Following the events of November 2003, the newly appointed Georgian authorities have expressed a strong commitment to democracy and to a market economy. The 4 January 2004 presidential and 28 March parliamentary elections demonstrated notable progress over previous elections and brought the country closer to meeting international standards for democratic elections. The authorities have indicated their commitment to addressing the main problem areas affecting Georgia, namely the investment climate including organized crime and corruption, governance and structural issues within the energy sector and the weak external position. On June 16, the government very successfully presented to a high level donor co-ordination meeting held in Brussels, a prioritization of strategic reforms that underlined its commitment to immediately addressing corruption, administrative, civil service, fiscal and public finance reforms.

After a slowdown in the aftermath of the Russian crisis, real annual GDP growth gradually recovered to about 5 per cent during 2002 and accelerated to an estimated 8.6 per cent in 2003 reflecting strong growth of construction particularly from commencement of work on the BTC pipeline. The prudent monetary policy of the National Bank has ensured currency stability and achievement of inflation targets (less than 6 per cent) during the past two years. Projected GDP growth for 2004 is at 6.0 per cent.

Georgia has an important geographic position as a transit point linking the energy rich countries of the South Caucasus and Central Asia with Europe. At the same time, Georgia is part of the transport corridor from Europe to Central Asia, (TRACECA), which follows the historic silk route and is of strategic importance to the countries in the region as an alternative transport link to Europe. Physical infrastructure, both road and rail (still in state hands), has become dilapidated due to lack of investment. Georgia’s two main ports, Poti and Batumi, are still state owned and operate inefficiently due also to the bureaucratic barriers raised by customs and tax authorities. The efficiency of Poti Port is expected to improve since a concession for some parts of the operation of Poti Port was given in August 2003 and a tender for the remaining parts has been opened. The challenge in rail transport is restructuring and commercialization of the sector.

Construction of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline will provide revenues for Georgia of around US$10m during 2005 increasing to around US$ 50 million per annum at peak through put levels during 2009 -12. Total revenue over the lifetime of the pipeline is estimated at US$ 580m.The South Caucasus gas pipeline is expected to start operation soon. In order for Georgia to fully benefit from the BTC and SCP pipelines transparency in revenue management will be essential and transparency principals that are consistent with the Extractive Industries Transparency Initiative have been agreed with BP, the government and the Bank. A Regional Development Initiative (including a co-financing facility to be co-funded by the EBRD and the pipeline sponsors) is designed to complement the implementation of these two major regional pipelines.

Kyrgyz Republic

The Kyrgyz Republic is committed to and is continuing to make progress towards implementation of the principles of Article 1 of the Agreement Establishing the Bank, although the last parliamentary and presidential elections did not fully conform to OSCE standards. A new round of parliamentary and presidential elections is to take place in 2005. A key issue is the succession to President Askar Akayev, as the Constitution limits the President's terms in office to two. There was deterioration in the area of freedom of the media, although an independent printing house was allowed to begin operations. Albeit subject to Government pressure at times, civil society and the political opposition are generally able to voice their concerns about Government policy.

The investment needs in infrastructure are considerable, but constrained by limited public resources and limits on sovereign borrowing. Given the Bank's inability to provide concessional loans, the Bank will consider financing non-sovereign infrastructure that produces cash flows to meet debt repayments without recourse to sovereign guarantees. The Bank will coordinate closely with other donors, IFIs and the Kyrgyz Government on the overall investment priorities of the country in the context of the National Poverty Reduction Strategy (NPRS). The Bank will seek opportunities to support privatization of key infrastructure. For example, having provided TC to the telecoms regulator over the past few years, the Bank would seek to finance KT's investment needs, should ongoing contract negotiations result in a successful sale to a qualified investor. The Bank is working with other IFIs on potential concession projects, most notably SeveroElectric.

Moldova

The transport sector remains one of the least developed sectors mainly due to lack of sufficient funding for maintenance and investments. The efficient operation of the transport sector is important to support Moldova's economic recovery and growth. The country's geographical position, including its future closeness to the European Union, can have a significant impact on the country's development but requires, on a priority basis, the rehabilitation of major international routes.

The road sub-sector carries over 80 percent of all domestic traffic. The road network is extensive in relation to the country's size. However, during the last ten years, due to lack of resources, the state has not been able to invest into road rehabilitation and adequate maintenance, and, as a result the road network has significantly deteriorated. This is continuing and, if no remedial actions are taken soon, the cost of rehabilitation will increase significantly.

Tajikistan

Over the past two years Tajikistan has made progress towards implementation of the principles of Article 1 of the Agreement Establishing the Bank. Progress towards a market economy was clearly evident, while transition towards a multi-party democracy and pluralism remained uneven, with the last parliamentary elections in February 2005 failing to meet international standards, despite showing some improvement over previous elections.

Macroeconomic conditions have improved during the past two years. The economy grew by 10% annually during 2002-2004, supported by increased consumer spending fuelled by higher incomes and foreign remittances as well as greater output of aluminium. A sharp reduction in inflation was also observed during the course of 2004, partly thanks to improved monetary policy and its governance. The state budget remains in near balance (excluding public investment programmes) and the expenditures are in line with the objectives set out by the Poverty Reduction Strategy Paper (PRSP). Moreover, the bilateral debt reduction agreements with Russia and Pakistan have led to a significant improvement in the external debt position, reducing the external debt to GDP ratio to 40% from 82% two years ago. Nevertheless, given the limited fiscal resources, the government continues to limit externally financed public investments to four percent of GDP annually. The authorities continue to refrain from borrowing any non-concessional loans

The main transition goal in this sector is to improve the quality of transport infrastructure in a way that is commensurate with the limited public resources available and that creates the basis for sustainable future operations of infrastructure enterprises, where possible through the attraction of private investment. As mentioned in Section 2.3.3, the state of infrastructure deteriorated sharply during the last decade due to poor maintenance and lack of new investments. The Bank will aim to support new investment selectively in the light of the limited borrowing capacity of the country.

Roads

The key road sector issue today is the establishment of an effective road maintenance program and how to implement a road rehabilitation program. Currently many kilometers of the main road network are effectively lost each year due to lack of adequate maintenance. The future cost of reinstating these into the network will be many times the cost of an adequate maintenance program. The Bank will seek to promote the allocation of adequate budgetary resources for road maintenance budgets and to increase the effectiveness with which funds are used.

The Bank will focus on road rehabilitation projects that facilitate internal communication within Tajikistan and also regional trade with neighboring countries, especially the Kyrgyz Republic and Afghanistan. Such projects would assist with poverty reduction and promote economic growth through infrastructure rehabilitation and foster regional cooperation. Focus on rehabilitation will also promote transition impact by strengthening public sector governance, and making more effective use of public funds.

Aviation

The aviation sector will continue to play a vital role for land-locked Tajikistan. Increased labor mobility with the Russian Federation (remittances from Tajik workers are anticipated to increase, raising foreign currency resources), trade within the region and the rest of the world, and development of the tourism sector depend significantly on aviation. The Bank has been active in the sector for some time with assistance for the renovation of airport runways, air navigation modernization and a project preparing for the modernization of the Tajik air fleet. Throughout, Bank assistance has supported reforms in the sector, mainly with technical cooperation programs. The regulatory functions of the Tajikistan State Air Company (TSA) were transferred to a Civil Aviation Department within the Ministry of Transport in 2001. Further, the Bank has been supporting the restructuring of TSA through creating initially three business units (air transport services, airport services and air navigation services). In the context of the Fleet Modernization project, the Bank will continue to engage with TSA and the government on further reforms.

Uzbekistan

In the last several years, the Bank has become increasingly active in the transport sector in Uzbekistan to support the rehabilitation of existing transport assets as well as the development of new market-oriented transport links, in particular with the railways sector. Similar opportunities for the Bank to contribute to road sector needs and sector reforms will also be sought if the policy environment is receptive. However, the Bank will proceed cautiously and selectively in developing further projects in this sector, in light of the limited foreign debt services capacity of the country.

5.5.2 Intermediate Transition Countries

In the Intermediate Transition countries: Bulgaria, Kazakhstan, FYR Macedonia, Romania and Ukraine, the Bank will continue to pursue business in the sovereign sector, state sector non-sovereign and private sector.

Issues continue to be consistent with those set out in the 1997 Transport Operations Policy, namely that in some of these countries substantial business in the sovereign sector has already been undertaken, bringing into play country portfolio ratio issues. Private sector activities continue to develop, but do not yet play a significant role in the provision of transport infrastructure. The Bank will continue to undertake sovereign transactions on a selective basis with some public sector non-sovereign transactions a possibility, as state owned entities continue their transition. In addition to these considerations, Bulgaria and Romania are currently preparing for accession to the European Union in 2007 and the Bank can expect to cooperate closely with the EIB and the European

Commission in order to leverage its transition impact in these countries. More complex, structured transactions are difficult to implement in the Intermediate Transition Countries, often because of inadequate or inappropriate legal structures and procedures. The Bank can be instrumental in achieving transition impact by working to implement such projects and using their requirements as a driver for legal and structural reform. As a consequence, the Bank will seek to work on such transactions in the Intermediate Transition Countries when suitable opportunities arise.

Bulgaria

Bulgaria continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Under Prime Minister Simeon Saxe-Coburg-Gotha, in office since June 2001, the country has been well regarded for its pursuit of economic and financial reforms. It is a candidate for EU membership at the next accession round in 2007. Improved political stability on a regional level has led to signing of free trade agreements with all neighbouring countries and an increasing role for Bulgaria as a regional energy hub. The proposed strategy aims to provide strong support to Bulgaria's efforts to accede to the EU.

In the transport sector, slow reform and slow restructuring of the railway sector has hampered the Bank's efforts, although the financing of Bulgarian Railways led to an improved management information system, introduction of Public Service Obligation in the context of an agreed Restructuring Action Plan and exposure to Export Credit Agency ("ECA") financing. More recently the Bank has increased its presence in the sector through a non-sovereign syndicated loan to the City of Sofia to support the development of its urban transport system. This project brought about involvement of the private sector in the provision of bus services and maintenance work for the first time in Bulgaria.

Kazakhstan

Over the two years since the adoption of the last country strategy, Kazakhstan has continued to make progress towards implementation of the principles envisaged in Article 1 of the Agreement Establishing the Bank. Visible progress has been made in market-based economic reforms, while political reforms were slower and did not match economic achievements. Strong presidential power is ot adequately balanced by the legislature or judiciary, and pervasive corruption remains a problem. The registration of opposition parties and the abandonment of a controversial proposed media law were positive steps in the country's democratic transition. The parliamentary elections in September 2004 fell short of international standards, although they represented an improvement over previous parliamentary polls.

In the area of transport infrastructure, which is closely associated with investment needs for natural resources, the public sector remains dominant and reform progress has been relatively slow. The telecommunications sector reforms also lag behind other CIS countries such as Russia. For Kazakhstan to meet huge investment requirements, private sector participation is essential because it will enhance efficiency and generate transfer of skills and technologies. The key challenge for the Government is to establish and enforce credible "rules of the game" through effective laws and strong, clear regulations in order to attract private investment.

The development of a further transport network, including pipelines, is critical for Kazakhstan to gain access to international markets. Reforms of the railway sector that would open it to third-party operators are finally being implemented. Earlier efforts to reform Kazakhstan State Railways (Kazakhstan Temir Zholy or KTZ), which is estimated to carry in excess of 70 per cent of the country's freight ton-kilometres and approximately half of the total passenger-kilometres, including urban services, have been derailed by management changes and the Government only agreed on a restructuring programme in February 2004. Based on this programme, KTZ was split into several joint-stock companies. KTZ itself was turned into an infrastructure company with responsibility for tracks, track maintenance and train movement. Separate companies were created for the operation and maintenance of locomotives (JSC Locomotive) and freight wagons (JSC KazZhelDorTrans). The operation of passenger services had already been unbundled in 2003 with the creation of six regional companies. The ownership of these will be transferred from KTZ to the Ministry of Transport on 1 January 2005. The current subsidy system of discounted infrastructure access charges for passenger transports will be replaced by explicit payments from the state budget to operators for the operation of loss-making, but socially important inter-city routes in 2005. Non-core companies will be sold through open tenders between 2004 and 2006. Track access charges will be regulated by the AMA which needs to further develop and implement an appropriate tariff methodology. Most importantly, as state-owned freight operators will compete with private operators, non-discriminatory access policy should be implemented.

Regulatory framework for other transport infrastructure, such as oil and gas pipelines, which are important for the growing oil and gas sectors, requires further strengthening. While the Government has received assistance from USAID for the development of tariff methodology for the use of oil and gas pipelines, further work is needed in order to implement this methodology. Furthermore, there is regulatory uncertainty over the access regime to oil and gas pipelines that are controlled by subsidiaries of KMG. With the opening of CPC pipeline in 2001, there are currently no export bottlenecks.13 However, as output is set to rise, especially when Kashagan field comes on stream after around 2007, the access issue will become more pertinent. The third party access regime to the oil berths at Aktau port also requires further clarification.

Public financing primarily develops Road and aviation sectors. In recent years, road sector development has received a large allocation from the central budget. Key challenges in the road sector are to prioritize investment and to separate regulatory functions from project planning and execution functions.

FYR Macedonia

The Former Yugoslav Republic (FYR) of Macedonia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. The new Government elected in September 2002 has continued the implementation of the Ohrid Framework Agreement. Political stability and military security have been restored since the security crisis in 2001. Following the death of President Trajkovski in February 2004, Branko Crvenkovski, Prime Minister since the 2002 elections, was sworn in as the new President in May 2004. A new Government was appointed on 2 June 2004 with Hari Kostov as Prime Minister and with no major ministerial reshuffle. FYR Macedonia has continued to promote regional co-operation in south-eastern Europe in a number of ways, including through political dialogue, intra-regional trade agreements and regional infrastructural interconnections. Its Stabilisation and Association Agreement with the EU entered into force on 1 April 2004 and the country presented its application for EU membership on 24 March 2004.

During this strategy period, the Bank’s focus will be on the implementation of the Regional Roads Project (East-West Corridor VIII and North-South CorridorX), making sure that the environmental issues raised during the preparation of the Skopje bypass component are properly addressed. This will be achieved, inter alia, through the appointment of an Environmental Monitor and the establishment of an Environmental Monitoring and Advisory Group (EMAG) in summer 2004.

In parallel, the Bank will assist the authorities in preparing an Institutional Strategy and a Roads Plan. The objectives are to improve the road financing mechanisms, to bring about competition in road maintenance and to implement an effective road planning system. As a follow-up, the Bank will seek to develop a road rehabilitation project, possibly with the EIB, which will be combined with sector reform, particularly related to enhanced competition in road maintenance and restructuring of the state-owned road maintenance company.

Under its current Civil Aviation Upgrading project, the Bank will assist with the separation between the Air Navigation Services provider and regulation aimed at institutional and structural reorganization of the Civil Aviation Administration through the establishment of an independent financial and autonomous service provider for ANS.

In addition, the Bank will consider financing the modernization of the Skopje airport and review the most appropriate solution, including possibly private sector participation.

Romania

Romania continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Under the Social Democratic government of Prime Minister Adrian Nastase, which took office in December 2000, the country embarked on a comprehensive program of economic reforms that aimed at combining market reforms with improved social conditions, with an equal emphasis on both. The accelerated drive to join the European Union was, and still is, seen as the indispensable framework for the implementation of this program. The Nastase government, though lacking majority in Parliament, has succeeded in ensuring political stability by establishing an alliance with the Democratic Union of Hungarians in Romania (UDMR). Improved regional political stability has led to the signing of bilateral free trade agreements with most of Romania's neighbors and the planning of a regional energy market. Romania is a candidate to join the European Union (EU) in the next accession round in 2007 provided it makes significant progress in several fields notably in the implementation of the reform of the civil service and of the judiciary and in the fight against corruption.

The Bank will continue to support the on-going process of commercialization and to explore ways to increase non-sovereign opportunities in the transport sector. Specific activities may include supporting the National Administration of Roads in restructuring its activities, strengthening its capabilities to act as administrator of contracts with the private sector and encouraging greater private sector involvement in the development and maintenance of the road network. In addition, selected infrastructure investment in key rail corridors to complement the on-going Instrument For Structural Policies For Pre-Accession (ISPA) program will be supported.

Roads. The main challenges in the road sector over the next few years are to continue commercialization and privatization of operational activities, increase private sector participation, including establishing roads operated by the private sector under concession arrangements and improve road sector public finance to move towards full cost recovery. The public sector's capabilities in preparing projects for tender, tendering, negotiating and administering such contracts will need strengthening, to maximize the benefits arising from private sector involvement.

Railways. Following the Bank's first railway Project in Romania, signed in 1997, the Government of Romania reorganized the Romanian National Railways into five separate companies, which commenced independent operations in October 1998. The changes agreed with the Bank in the Railway Restructuring Plan have led to considerable improvements in financial transparency in the sector. Whilst the separation of businesses created the need for additional administrative structures, it has also provided new management focus, which has highlighted deficiencies in services and cost inefficiencies in service provision. The newly established companies continue to require support in terms of investment and commercialization.

Ports & Inland Waterways. The development and rehabilitation of port infrastructure will remain one of the transport infrastructure priorities in view of the importance of the ports to the Romanian economy. The main objective would be to develop a balanced approach to financing using public funds where necessary but at the same time increase efforts in attracting private sector initiatives, in particular, in the area of port terminals.

Specific activities may include:

• Additional support to the National Roads Administration to restructure its activities and provide a further sovereign loan for development of the Cluj Bypass, together with support for the tendering and implementation of future road PPPs; and provide finance for various sections of the Bucharest to Brasov or other motorways.

• Support to the Romanian Rail Infrastructure Company in selected investments along the key transport corridors to complement the on-going ISPA funded program on Trans- European Network Corridors.

• Lending on a non-sovereign basis to the train operating companies, to upgrade rolling stock and encourage policies aiming at commercializing / privatizing operations.

• Safety related rehabilitation investments in the inland waterway sector.

• Investment support for port infrastructure projects, which are required for operational safety reasons or are needed to attract the private sector participation in development of future port operations.

Ukraine

Ukraine has come through a difficult political test and now stands at a critical juncture in its transition. The democratic election of President Viktor Yushchenko has re-affirmed Ukraine's adherence to the principles of multiparty democracy and pluralism contained in Article 1 of the Agreement Establishing the Bank.

The core institutions of democratic governance – transparent elections, an independent parliament, active civil society and the rule of law – were all strengthened as a result of the prolonged election process. The new government is preparing a program to address Ukraine's key transition challenges and to get closer to EU standards and values. The Bank is committed and well positioned to assist the Ukrainian authorities in this respect.

Transition goals

Key transition goals in the transport sector are:

- Further tariff reform, restructuring and commercialization in the road and rail sectors;

- Greater involvement of the private sector in port operations and state-owned shipping activities; and

- Greater commercialization and the further involvement of private capital in the aviation sector.

Operational focus

Despite the progress achieved to date, there is still a considerable need for investment in transport infrastructure to facilitate regional economic growth and integration.
Subject to confirmation by the government, the key areas of operational focus will be:

- In the short term, to implement the existing priority projects already agreed between the Bank and Ukraine. These include further rehabilitation and if possible completion of the M06 Kiev-Chop highway, which is a key transit corridor linking Ukraine with Central and Western Europe the Bank will also seek to support upgrading of other major roads identified as a priority by the Government, which are part of the pan-European network, such as M05 Kiev-Odessa highway;

- In the short term, and subject to the availability of a sovereign guarantee, the Bank is willing to finance the modernization of the port of Illichevsk and other Ukraine large seaports;

- In the short term, the Bank will also seek to finance construction of port terminals on a private basis;

- In the short term, the Bank will seek to finance, where possible, renewal and upgrade of the railway rolling stock and possibly aircraft fleet through corporate or structured finance instruments;

- In the medium term, and subject to progress of the sector reform program and the availability of sovereign guarantees, the Bank will also consider further projects to develop railway and harbor infrastructure;

- In addition, in the medium term, the Bank will seek to provide further support to the shipping industry and upgrading of selective shipyards. For state owned activities in these sectors, the Bank's involvement will be conditional on a commitment to restructuring and commercialization;

- In the medium term, where possible, the Bank will seek opportunities to participate in development of airport infrastructure alongside private partners and will investigate opportunities to support development of regional airlines;

- The Bank will seek to involve EIB in financing of its major transport infrastructure projects in Ukraine.

5.5.3 Advanced Transition Countries

The Advanced Transition Countries comprise the eight of the Bank's countries of operation which acceded to the European Union on 1 May 2004 (the "New EU Members"), namely: Estonia, Latvia, Lithuania, Poland, The Czech Republic, Slovakia, Hungary and Slovenia and in addition to these eight countries, Croatia.

Estonia

Estonia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Following the positive outcome of the September 2003 referendum, and after successful negotiations regarding signature of the accession treaty built on a high level of alignment with the acquis communautaire, Estonia joined the EU in May 2004. Over the past decade of transition, Estonia has made remarkable progress in structural reforms. It has maintained the most liberal foreign trade regime of all transition countries and more than 80 per cent of economic activity is now in private hands.

Nevertheless, unemployment continues to be high, income per capita levels are still among the lowest in acceding countries, and a number of important reform challenges still remain. In particular, a main challenge will be to promote domestic savings in order to make high rates of domestic investment less reliant on foreign financing. In this context ongoing progress with structural reforms is necessary, by further strengthening private sector development, commercializing municipal infrastructure, further restructuring the energy sector, and strengthening non-bank financial institutions for deeper financial intermediation. The proposed strategy has been developed to help address a number of these challenges.

Municipal transport infrastructure is a priority area for the Bank. It will aim at financing national and municipal entities with a view to supporting their priority investment needs, while facilitating their further commercialization, restructuring, and private sector participation. Financing would be provided on a private basis where feasible, also to help alleviate fiscal pressures.

Latvia

Agreement Establishing the Bank. In recent years Latvia has made substantial progress in transition and this Strategy document recognizes the laudable success of Latvia and its economy. Some 75 per cent of economic activity is in the private sector and price and trade liberalization, enterprise privatization and effective financial sector reforms have taken place. As a performing market economy, there is an open foreign trade regime and no major constraints to foreign investment.

In ***railways***, operating and policy setting functions have been separated and core railway businesses have been partly unbundled while ancillary services have been divested. The Ministry of Transport recently announced plans to restructure Latvian Railways into three independent companies (infrastructure, freight and passengers) by the end of 2005. Infrastructure access is granted legally and some independent operators have been licensed. A number of regulatory agencies (licensing, pricing and safety issues) have been established. In ***roads***, construction and design companies have been privatised. Road user indirect charges have increased, but still do not cover operating costs. A toll bridge is being considered for the Daugava River in Riga. National road networks are in relatively poor condition.

Lithuania

Lithuania continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Following the positive outcome of the May 2003 referendum, and after successful negotiations regarding signature of the Treaty built on a high level of alignment with the acquis communautaire, Lithuania is now scheduled to join the EU in May 2004.

Over the past decade of transition, Lithuania has made substantial progress in structural reforms, through the early liberalization of prices and trade, the rapid privatization of enterprises and gradual strengthening of the financial sector. Nevertheless, incomes per capita levels are still among the lowest in acceding countries. The structure of the economy does not yet reflect that of advanced industrialized economies, and low productivity in agriculture remains a problem.

A number of important reform challenges still remain to enable rapid convergence to average EU income levels. In particular, the main challenge will be to strengthen domestic savings in order to accumulate adequate wealth for growth in standards of living in the future and to make high rates of domestic investment less reliant on foreign financing. In this context ongoing progress with structural reforms is necessary, such as the completion of privatization, improvements to the business environment, further commercialization and deregulation in the infrastructure sphere, strengthening of non-bank financial institutions and reforming the inadequately targeted social safety net. The proposed strategy has been developed to help address a number of these challenges, and to support Lithuania's transition towards a market economy in the context of the country's accession to the EU.

In 2003, the Bank approved a general obligation loan to the City of Vilnius to finance priority street improvements related to a major land development scheme as part of the implementation of the City’s Transport Master Plan. The main transition impact will be achieved with a Capital Development Program, which will improve the City’s capital budgeting procedures and improve the City’s infrastructure financing capacity.

Poland

Poland continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Poland has made great progress in the transition process with a large degree of market and trade liberalization, no significant constraints to foreign investment and over 70 per cent of GDP generated by the private sector. On the threshold of accession to the European Union, Poland can be praised for its past leadership in undertaking important structural reforms, which resulted in strong macroeconomic performance, including a low current account deficit, low inflation and positive growth outlook.

However, little further progress has been achieved during the past three years to improve the investment climate, the competitiveness of the economy and the level of administrative capacity. Important differences remain between Poland and advanced market economies, including the existing European Union member countries. The future of Poland will be closely linked to its capacity to attract investment and create jobs – only this will enable Poland to achieve its real growth potential and tackle what may be the greatest challenge, reduction of high unemployment. In order to effectively compete within the region for investment, Poland must accelerate reforms, which have stalled and temper the propensity to run large fiscal deficits.

As a result of an expansionary fiscal policy, public debt levels have increased and have adversely affected growth and financing of the real economy; consequently, there has been both a sharp contraction in fixed investment as well as falls in foreign direct investment inflows. Sustained economic growth at a high level will only be achieved through private sector investment and not through expansionary fiscal policies; critical to maximizing growth potentials will be foreign investment as the pace of domestic wealth creation may remain insufficient for some time to come.

Railways: Following earlier railway infrastructure investment, the Bank has actively supported the reorganization of the railway sector by providing the first labor restructuring loan for the Polish State Railways (PKP) redundancy program and subsequently assisting in financial restructuring of the newly created PKP Holding Company. Through its active involvement with PKP, EBRD has been able to participate and support the restructuring and reorganization of the largest railway industry of the pre-accession countries. (2) *Roads:* The Bank's work on the PPP structure for the A1 motorway and its involvement in the development of the Road 19 PPP have highlighted various issues relating to institutional and legal impediments that need to be addressed to allow the successful use of private investment to provide public infrastructure. The Bank, cooperating with the World Bank and EIB, has participated extensively in policy dialogue aimed at road sector reform and moving forward motorway development and financing.

In respect of the *rail sub-sector*, given its national importance and extremely difficult financial situation, the Bank will seek to provide continued support to implementation of restructuring, modernization, commercialization and privatization in the rail sector through targeted investment projects and technical co-operation. The Bank will continue to encourage privatization of PKP Cargo and will seek to make available necessary long-term investment finance to creditworthy PKP Group subsidiaries on a commercial basis, thereby encouraging lending by commercial banks which to date have been reluctant to provide investment finance given the risks of policy change. In respect of the *road sub-sector*, since new road construction is expected to be financed largely from the EU Cohesion Funds with matching funding from the EIB or the state budget, the Bank will focus primarily on supporting and developing opportunities for private sector involvement in the road sector, for example private operation and maintenance of motorways by direct involvement of private sector operators which are interested in concession opportunities and are expected to be present in the road sector in the near future. It would also seek to participate in the financing of PPPs for new road construction should these be developed alongside the traditional construction program. Policy dialogue will remain an important component of the Bank's engagement in the transport sector.

With respect to PPPs, the Bank will target its support to projects where a PPP structure is likely to deliver efficiency gains (e.g., through whole life costing approach), where there is a strong political will to develop and sustain a PPP approach and when there is a clear expectation that the Bank will be additional in its financing.

Czech Republic

In ***railways,*** operating and policy setting functions are separated and the infrastructure company is separated from operating companies (passenger, freight, etc.). In January 2005 the European Commission approved the Czech Republic's plans to financially compensate those who will be hit by the restructuring of the Czech national 100 per cent state owned rail operator Ceske drahy. The Czech government expects to spend a total of CZK 1.86 billion to compensate employees who will have to be laid off. The number of employees eligible for the grant is estimated to be 11,100 of the 16,000 to be dismissed in 2004-2008. Some 6,000 of CD's 70,000 employees are scheduled to be dismissed in 2005 (following the dismissal of 6,800 employees in 2004). The restructuring of the railways companies envisages the transfer of the entire freight and passenger transport divisions into separate holding subsidiaries. There is limited private sector participation (e.g. some local passenger lines). An independent regulator for licensing was established, but prices are regulated by the Ministry of Transport. In ***roads,*** road and motorway directorate is semi-independent.

Ancillary services have been divested. There was an attempt for a road concession (i.e. D47), but the tendering process was not transparent and subsequently cancelled.

Transition Goals

• Contribute to the increase of the absorption capacity of the country with respect to EU funding of infrastructure projects necessary for development of economy and private sector growth.

• Contribute to the success of the new Public Private Partnership initiative with the aim to deliver infrastructure in a cost effective and timely manner including its operation and maintenance over a long period of time.

• Support improvement of energy efficiency of the economy through promotion and mplementation of ESCO projects. Contribute to the fulfilment of national targets
concerning increase of percentage of renewable energy in overall energy consumption
.

Operational Priorities

• Support of private sector participation in financing of at least one major infrastructure or municipal services project through an off budget structure, providing long term financing or equity. For smaller municipalities, wherever possible, use financial intermediaries.

• Support ESCO projects in the private sector as well as the public sector working closely with regional authorities to improve energy efficiency of schools and hospitals. Consider a risk sharing scheme for a portfolio of smaller energy savings projects funded by a local bank.

• Identify and provide funding for efficient renewable power projects working with local entrepreneurs as well as foreign sponsors.

Slovak Republic

The Slovak Republic has made considerable progress in transition with an estimated 80 to 90 per cent of economic activity in private hands, a large degree of price liberalization, an open foreign trade regime and no major constraints to foreign investment. Following remarkable years of reform and adjustment, the Slovak Republic joined the EU on 1 May 2004.

EU Cohesion and Structural Funds will be used for developing (1) transport links, essentially roads and railways, and (2) environmental purposes, like protection and rational use of water and air, or processing of waste. A third type of objective will be the upgrading of local infrastructure, including renovation of schools and health care facilities, modernization of employment services, programs for job applicants and rural development. The completion of this last objective will depend to a great extent on the capacity of regions and municipalities, in the context of the decentralization of responsibilities and spending initiated by the Government, to mobilize co-financing in order to complement EU funds. In addition, the transformation of the water industry from state-owned to regional companies owned by municipalities will require organizational work to ensure that they function efficiently and take full advantage of private sector participation where possible.

Hungary

Over the last 15 years Hungary has made remarkable progress in transition and it is one of the most advanced countries among the new EU member states with about 80 per cent of economic activity in private hands, a large degree of price liberalization, an open foreign trade regime and liberal foreign investment conditions.

The accession of Hungary to the EU in May 2004 has positively influenced output growth and trade, agricultural incomes and infrastructure investment. Economic growth reached 4.2 per cent in 2004, up from 2.9 per cent in 2003, due to an increase in private investment, increased exports, and strong growth in agricultural production.

However, macroeconomic imbalances remain significant. The fiscal deficit declined to 5.4 per cent of GDP in 2004. This was lower than the 6.5 per cent deficit in 2003 but higher than the original target, highlighting the need for significant further fiscal measures in order to avoid a destabilization of the economy and enable Hungary's accession to the Euro zone as planned in the medium-term. Public debt reached around 57 per cent of GDP, with significant infrastructure investments undertaken off budget. The current account deficit stabilized at around 8.8 per cent of GDP in 2004. Significant portfolio investments and foreign borrowing financed the external deficit. Net foreign direct investments (FDI) recovered in 2004, after a temporary fall in 2003, and were equivalent to about 40 per cent of the current account deficit. The attractiveness of the country as a destination for FDI is enhanced by a 16 per cent corporate tax rate and tax exemptions for foreign strategic investors, but high real wages relative to other countries in the region pose a challenge to future competitiveness.

The Hungarian government has embarked on an ambitious motorway construction program. Most of the investments are to be implemented by the state owned State Motorway Management Company (AAK.) PPP structures have been extended to a handful of projects, including the M1/M15 motorway and, the more successful, M5 and M6 motorways. Road sector finance in Hungary has been in line with EU standards but the quality of secondary roads remains poor and PPP structures are being considered for their development.

The railway sector is a clear laggard in the overall reform process. MAV, the national railway company has yet to undergo major restructuring, although operating and policy-setting functions have been separated and core railway functions have been divided into individual business units within the company while ancillary services have been divested. Access to the track is legally available but not fully working in practice. There is limited private participation in the sector and a long-term government vision has yet to be presented.

The privatization of Budapest Airport Ltd, the airport operator in Budapest, is likely to be completed in 2005. Regional airports are slowly being developed, with selective government support and limited private involvement, for charter and low cost flights as well as air cargo.

Slovenia

The Republic of Slovenia is committed to and applying the principles of multiparty democracy, pluralism and market economics and therefore continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Over the past decade it has achieved substantial and continuous progress in its transition to a market economy. Nevertheless, important challenges lie ahead, in particular for the Slovene economy to pursue its integration in the enlarged European Union and play an active role at the regional level.

The objectives set out by the Slovene authorities in their long-term strategy aim for Slovenia to achieve a greater level of competitiveness and internationalization. Identified challenges include promoting the growth/development of domestic companies in Slovenia and abroad, attracting further foreign investment, enhancing the business environment, and fostering the development of high value added activities, with a special attention to small and medium-sized enterprises (SME), service activities, and reducing regional disparities.

Slovenia can access a wide range of sources of financing, including international financial markets thanks to its economic success and stability. However, higher risk financial instruments, like long term structured finance, equity and quasiequity or private-public partnerships offer yet unexploited alternatives to support the private corporate sector, especially SMEs.

The restructuring of the railway sector was launched by the government with the amendment of the Railways Transport Act in 2003. From a regulatory perspective, this revision establishes a regulatory body, the Rail Agency, and includes a plan for splitting the former single operator into three entities in charge of passenger transport, cargo freight, and management of the network. However further progress will be needed as the administrative capacity of the regulator, the Rail Agency, will have to be strengthened through specialized training of staff. The methodology for infrastructure charging also remains to be defined, as noticed by the European Commission. The plan also provides for the financial and industrial restructuring of the railway operator, which returned to profitability for the first time in years in the first half of 2004.

As regards road links, Parliament also adopted in late 2003 a new program for the construction of an additional 539 kilometers of motorway to extend the current network. In addition a bill was adopted in 2003 that transforms the Slovene Motorway Company (DARS) from a public utility into a contractor of the state by changing its legal status from a public stock company into a regular stock company. The change is intended to allow for the participation of private sector operators to the construction, management and maintenance of motorways.

Russia

The Russian Federation is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank; however, in the past Strategy period, application of these principles has been uneven.

Political stability and consolidation – notably through the confirmation of a reform-minded government, the creation of a strong parliamentary majority and the establishment of a common legal space across the Federation – is an important achievement, which can contribute positively to the country's continued structural reform efforts. Following a wave of terrorist attacks in the North Caucasus and in Moscow, the government has taken steps to reinforce public security and re-establish central political control over the regions. Recent political developments suggest a concentration of power in the hands of the executive and a perceptible drift from democratic practice that has raised concerns in the international community. At the same time, a robust system of checks and balances is the most effective way to guard against potential abuse of power and to encourage policy innovation. In this connection, the Bank welcomes the statement made by the President following his re-election, defining the creation of "a free society of free people” in Russia as the foundation for economic growth and political stability.

Russia’s economic performance over the past two years has been robust, with strong GDP growth and a sharp acceleration in domestic investment. Management of public finances has been sound, with the federal budget running a large overall surplus for the fifth consecutive year in 2004. Inflation has gradually declined while the exchange rate has remained firm. Foreign investment into Russia has also accelerated, including in the form of FDI inflows. However, the accumulated stock of FDI amounts to about 6.5 per cent of GDP: only a fifth of the average level of the other European transition economies. The current account has recorded large surpluses in recent years and reserves are at record highs. However, following years of substantial declines, net private capital outflows have increased significantly.

Structural and institutional reforms have remained on track over the past two years, with progress on several fronts, including tax and fiscal reforms, trade and currency liberalization, advances in creating a new pension system, initial stage reform of the banking sector, public administration, restructuring of the power and railway sectors and in improving the regulatory framework for SMEs. Notwithstanding this positive record, the election cycle in 2003-2004 brought a deceleration in the pace of reform in important areas and reform implementation in general remains a major weakness. The investment climate has continued to improve in many respects. However, significant uncertainties and risks have emerged with regard to the protection of property rights, and there have been conflicting signals regarding the role of the state in the economy. Corruption also remains a serious problem. According to Transparency International's Corruption Perceptions Index for 2004, Russia's score of 2.8 out of 10 (where 10 is "clean") suggests that corruption is "rampant". Russia's score is better than most CIS countries, but well below that of the advanced transition economies. Finally, the volatility of the financial markets and capital flows, as well as the recent banking sector turbulence, are important reminders of how vulnerable the economy remains and of the fragility of the confidence-building process.

Although the country’s overall macroeconomic and reform performance has been positive, it is not yet based on solid fundamentals. Growth – though helped also by a fundamentally sound macroeconomic policy framework and the beneficial impact of previous reforms – has been to a large extent driven by a combination of favorable external factors, including high commodity prices, abundant global liquidity, low interest rates and strong investor interest in emerging markets. Moreover the influence of two additional ‘temporary’ factors in Russia’s macroeconomic achievements – the boost in competitiveness stemming from a sharp devaluation of the trouble in 1998 and the availability of under-utilized productive capacity – have already begun to taper off as growth drivers.

The challenge ahead is to build the foundations for consistently good long-term macroeconomic performance and steady improvements in living standards, as well as to make the economy less vulnerable to external developments.

Expansion and modernization of the country's transport infrastructure has become one of the top priorities for the Russian Government. A long-term Transport Strategy is at an advanced stage of preparation and is expected to be approved in the near future calling, among others, for the continuation of the railway and road sectors reforms; modernization of aviation, shipping and sea-ports; renovation of both airside and landside assets in airports; and increased private sector participation including through development of concessions and public private partnerships (PPPs).

The Bank, recognizing the critical importance of the transport infrastructure in both the creation of a single economic space within the Russian Federation and the country's integration into the world economy, will work together with the Government to promote practical implementation of key objectives of the Transport Strategy predominantly on a commercial basis. The Bank believes that this is one of the areas in which co-operation with EIB would be highly beneficial for all parties. The Bank through its policy dialogue initiatives will contribute to the development of the legal and institutional environment conducive to PPPs, concessions and other forms of private sector involvement in the transport sector. In supporting the implementation of the Road sector reform particular attention will be paid to increased transparency in project selection and allocation of maintenance funding and support of the purely private project initiatives. The railway sector reform, which entered in the second phase of its implementation in autumn 2003 and ensures non-discriminatory access for all market players to the railway infrastructure, offers a widening scope for private sector involvement in the financing and provision of railway services. In the freight sub-sector apart from supporting the growing number of private freight operators the Bank can also promote the development of private railway carriers and thereby promoting direct competition with the state-owned regional railway companies. As the reform process broadens possible new private sector clients can emerge as private rail maintainers, infrastructure companies and rail franchisees.

Developing private ports and terminals, landside airport assets, road haulage companies, leasing of airplanes and other assets, represents opportunities for private sector involvement in other sub-sectors.

The Bank will work to encourage institutional reform at the level of key state-owned infrastructure companies, which would create autonomous, revenue-generating entities, acting commercially as borrowers on a public sector, non-sovereign basis (e.g. RZD, Rosmorport, Air-navigation Corporation, and Airport GUP).

In some cases sovereign support will be required for projects of national and/or social priority and with positive overall economic return, but where cash generation is not sufficient to warrant non-sovereign approach. It may also be required where the assets are owned directly by the State and an autonomous borrower does not exist (e.g. the road sector, airside improvements in airports), as well as in cases where the risk (e.g. traffic risk) is simply too high to proceed without sovereign support. Where possible, the Bank will seek to "graduate" even this type of project from the sovereign to non-sovereign basis over time (e.g. where the reform process will eventually create autonomous borrowers, or where a project has the potential for achieving sustainable cash flows in the future). The Bank and the Government will establish a formal procedure for selecting sovereign loans where the sub sector or the nature of the project requires such support. The Bank does recognize that the availability of sovereign guarantees will be limited and is dependent on the Russian Government policy in relation to the choice between straight budget funding and IFI loans.

SECTION 6: STEPS FOR U.S. COMPANIES INTERESTED IN WORKING WITH THE EBRD IN THE TRANSPORT SECTOR

This section aims to provide U.S. companies with information on existing U.S. participation in EBRD activities and basic guidelines or "first steps" for working with the EBRD. It also contains references to more detailed resources.

Key success factors in working with the EBRD in the transport sector

The single most important asset a company can possess is knowledge of the market. In all cases, the bank prefers to do business with companies fitting the following profile:
- Demonstrable experience in the relevant country/ies, and in the sector; and
- Concentration on core competencies - this is not the place for experimentation.

The EBRD works with U.S. companies in three ways:

1) U.S. firms as Borrowers/Investors for Private Sector Sponsored Projects

U.S. firms sponsoring projects must be fully cognizant of the EBRD's mandate and criteria for projects and must have a well-prepared business plan that addresses the developmental mandate of the bank and financial risk.

- The EBRD typically funds up to 35 percent of the total project cost in the form of debt or equity, or both.

- Other investors make significant equity contributions.

- Private sector projects typically are based on 66 percent debt financing and 33 percent equity.

- Sponsor's equity can be in the form of equipment or machinery, and is usually at least a large as the bank's financing.

- EBRD typically invest in projects of over US$ 15 million.

- Projects must show clearly the impact of the project on the transition of the economy and demonstrate that a sufficient revenue stream can be established to service repayments.

The EBRD also provides direct financing and support for SME's through a number of loan and equity facilities. These include the Direct Investment Facility, which provides finance for SME's owned and managed by local entrepreneurs, and special regional investment funds. For more information on SME financing with the EBRD see the EBRD website:

2) U.S. firms as bidders on tenders as contractors for equipment, works and services on Bank financed public sector projects

Successful U.S. firms need to be fully responsive and competitive both in both the technical and financing portions of their bids. U.S. firms will be competing with other international firms who know the market and conditions very well.

Public sector projects are a substantial source of procurement contracts for U.S. suppliers. U.S. companies win almost 10 percent of all contracts going to western firms.

The borrower must follow the Bank's open tendering procedures on:

- Goods and services contracts > US$ 180,370 (Euro 200 000)
- Works contracts > US$ 4.5 million (Euro 5 million)
- Upcoming public sector projects are listed in the "Pipeline" section of the Bank's monthly Procurement Opportunities publication.

For more information on procurement procedures, policies and rules see the EBRD website at www.ebrd.com/english/procure/index.htm

3) U.S. firms as consultants and providing technical Services

Four of the top ten consulting contract winners are U.S. based. The EBRD works with consultants in three ways:

- Executing the Bank's technical cooperation program;
- Assisting in project preparation and implementation; and
- Performing due diligence.

All consultancy contracts of over Euro 50 000 (US$ 45,092) are published on the EBRD website: http://www.ebrd.com/english/procure/opportunities/main.htm.

Note that the deadline for responding to calls for expressions of interest for smaller projects is only five working days after publication. Such notices are frequently, but not always, published on a Wednesday.

The EBRD does not maintain a register of consultants, and it is up to U.S. companies to be proactive in monitoring the EBRD web site for contract notices. For more information on the selection process see www.ebrd.com/procure/opportunities/consultproc.htm.

Doing business in Central and Eastern Europe and the CIS offers profitable opportunities for U.S. firms. The economic, political and commercial environment, however, is diverse, complex and difficult. Therefore, it is essential that U.S. firms seeking to access and penetrate this market, develop an international marketing strategy. U.S. firms new to export, or new to market are advised to contact the nearest U.S. Department of Commerce Export Assistance Center. U.S. firms new to the EBRD and new to the region, or wishing to enhance their commercial activities in the CEE and CIS, are encouraged to contact the U.S. Commercial Service-EBRD, London, UK. Contact information is provided at the end of this report.

SECTION 7: CONTACT INFORMATION

1. Key EBRD Contacts:

All initial enquiries should be directed via the Commercial Service Liaison Office to the EBRD (CS-EBRD).

Ms Gurjit Bassi
U.S. Advocacy Center's Liaison Office to the
European Bank for Reconstruction & Development
London, U.K.
Tel: +44 20 7588 8439
Fax: +44 20 7588 8443
http://www.buyusa.gov/ebrd

The following is a key EBRD contact in the transport sector:

Roy Knighton
Transport Director
European Bank for Reconstruction and Development
One Exchange Square
London EC2A 2JN
United Kingdom
Tel: +44 20 7338 6000
Fax: +44 20 7338 6100

2. Other information resources that U.S. companies may find useful for this region:

The Electronic Bulletin Board (EBB) Operated by the US Department Of Commerce,
TEL: +(202) 482-1986;

The Eastern Europe Business Information Center, (EEBIC), (EEBIC Website: http://www.mac.doc.gov/eebic/ceebic.html)
Tel: +(202) 482-2645,
FAX: +(202) 482-4473, and the

Business Information Service for the Newly Independent States, (BISNIS), (BISNIS website: HTTP://WWW.BISNIS.DOC.GOV
TEL: +(202) 482-4655,
FAX: +(202) 482-2293.

For information on other Multilateral Development Bank funded projects, contact the Multilateral Development Bank Office, US Department of Commerce, Washington, D.C. Tel: +(202) 482 3399.

For general trade information call: 1-800-USA-TRADE.

3. List of EBRD Countries of Operations, including contact details for Resident EBRD offices in each country.

Albania
Torre Drin Building, 4th Floor
Abdi Toptani Street
Tirana
Albania
Tel: +355 42 32898
Fax: +355 42 30580
Head of Office: Giulio Moreno

Armenia
20 Bagramian Avenue
375019 Yerevan
Armenia
Tel: +3741 540 425
Fax: +3741 540 430
Acting Head of Office: Nikolay Hadjiyski

Azerbaijan
Landmark I, 4th Floor
96 Nizami Street
370010 Baku
Azerbaijan
Tel: +99 412 971 014
Fax: +99 412 971 019
Head of Office: Thomas Moser

Belarus
Gertsena 2
220050 Minsk
Belarus
Tel: +375 172 110 370
Fax: +375 172 110 410
Country Director: George Krivicky (based in Headquarters)

Bosnia and Herzegovina
4 Obala Kulina Bana
2nd Floor
71000 Sarajevo
Bosnia and Herzegovina
Tel: +387 33 667 945
Fax: +387 33 667 950
Head of Office: Serban Ghinescu

Bulgaria
17 Moskovska Street
1000 Sofia
Bulgaria
Tel: +359 2 9321 414
Fax: +359 2 9321 441
Country Director: John Chomel-Doe

Croatia
Petrinjska 59
5th Floor
10000 Zagreb
Croatia
Tel: +385 1 4812 400
Fax: +385 1 4819 468
Head of Office: Andrew Krapotkin

Czech Republic
Husova 5
110 00 Prague 1
Czech Republic
Tel: +420 222 814 555
Fax: +420 222 814 522
Country Director: Alexander Auboeck

Estonia
Roosikrantsi 11
4th Floor
10109 Tallinn
Estonia
Tel: +372 641 8 548

Fax: +372 641 8 552
Head of Office: Urmas Paavel

Georgia
Ninochkheidze 38
380002 Tbilisi
Georgia
Tel: +995 32 920 512
Fax: +995 32 923 845
Head of Office: Nikolay Hadjiyski

Hungary
Rakoczi ut 42
1072 Budapest
Hungary
Tel: +36 1 486 3020
Fax: +36 1 486 3030
Head of Office: Hubert Warsmann

Kazakhstan
Kazybek Bi 41
4th Floor
480100 Almaty
Kazakhstan
Tel: +7 327 2 581 476/416/417
Fax: +7 327 2 581 422
Country Director: Michael Davey

Kyrgyz Republic
26 Geologicheskaya Street
720005 Bishkek
Kyrgyz Republic
Tel: +996 312 530 012
Fax: +996 312 666 284
Head of Office: Fernand Pillonel

Latvia
Valdemara Centre
21 Kr. Valdemara Street
LV 1010 Riga
Latvia
Tel: +371 750 5520
Fax: +371 750 5521
Head of Office: Toby Moore

Lithuania
Šeimyniškiu 1A
4th Floor
LT-2600 Vilnius
Lithuania
Tel: +370 52 638480
Fax:+370 52 638481
Head of Office: Matti Hyyrynen

FYR Macedonia
Dame Gruev 14
Business Centre Intex
1000 Skopje
FYR Macedonia
Tel: +389 2 3297 800
Fax: +389 2 3126 047
Head of Office: Zsuzsanna Hargitai

Moldova
Room 309
31 August 1989 Street 98
MD 2012 Chisinau
Moldova
Tel: +373 2 210 000
Fax: +373 2 210 011
Country Director: George Krivicky
(based in Headquarters)

Poland
53 Emilii Plater Street
Warsaw Financial Center
Suite 1300
00-113 Warsaw
Poland
Tel: +48 22 520 5700
Fax: +48 22 520 5800
Country Director: Irene Grzybowski

Romania
8 Orlando Street
Sector 1
Bucharest
Romania
Tel: +40 21 202 7100
Fax: +40 21 202 7110
Country Director: Hildegard Gacek

Russia
36 ul. Bolshaya Molchanovka
Stroenie 1
121069 Moscow

Russia
36 ul. Bolshaya Molchanovka
Stroenie 1
121069 Moscow
Russia
Tel: +7 095/501 787 1111
Fax: +7 095/501 787 1122
Country Director: Victor Pastor

Russian regional office:
25 Nevsky Prospect
191186 St Petersburg
Russia
Tel: +7 812 103 5525
Fax: +7 812 103 5526
Head of Office: Robert Sasson

Russian regional office:
Office 404
46 Verhnerportovaya Street
690003 Vladivostok
Russia
Tel: +7 4232 51 77 66
Fax: +7 4232 51 77 67
Regional Representative: Elena Danysh

Russian regional office:
Office 605
World Trade Centre
44 Kuibishev Street
620026 Yekaterinburg
Russia
Tel: +7 34 32 59 61 50
Fax: +7 34 32 59 61 51
Regional Representative: Tatyana Yemboulaeva

Serbia and Montenegro
Genex Apartmani, B22
Vladimira Popovica 6
Novi Beograd 11070

Russia
Tel: +7 095/501 787 1111
Fax: +7 095/501 787 1122
Country Director: Victor Past

Serbia and Montenegro
Tel: +381 11 311 3201
Fax: +38111 311 4571
Country Director: Dragica Pilipovic-Chaffey

Kosovo office
MEB Building
Skenderbeu Street
Pristina, Kosovo
Tel: +381 38 248 153
Fax:+381 38 248 152
Head of Office: Zsuzsanna Hargitai

Slovak Republic
Grosslingova 4
81814 Bratislava
Slovak Republic
Tel: +421 2 5296 7835
Fax: +421 2 5292 1459
Country Director: Alexander Auboeck

Slovenia
Trg Republike 3
9th Floor
1000 Ljubljana
Slovenia
Tel: +386 14 26 3600
Fax: +386 14 26 3636
Head of Office: Murat Yildiran

Tajikistan
85/22 Internatsionalnaya Street
734001 Dushanbe
Tajikistan
Tel: +992 372 213 543/240 572/240 235/249 051
Fax: +992 372 219 832
Head of Office: Fernand Pillonel

Turkmenistan
95 Azadi Street
744000 Ashghabat
Turkmenistan
Tel: +993 12 51 01 49
Fax: +993 12 51 03 18
Head of Office: Jaap Sprey

Ukraine
27/23 Sofiyvska Street
01001 Kiev
Ukraine
Tel: +380 44 464 01 32
Fax: +380 44 464 08 13
Country Director: Kamen Zahariev

Uzbekistan
International and Banking
Financial Centre
1 Turab Tula Street
4th Floor
700003 Tashkent
Uzbekistan
Tel: +998 711 39 40 14
Fax: +998 711 20 61 21
Head of Office: Kenji Nakazawa